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C O N F I D E N T I A L SECTION 01 OF 04 MANAGUA 000808

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STATE FOR WHA/CEN, WHA/AND, WHA/EPSC, INR/IAA, AND EEB/OMA
STATE PASS TO OPIC AND USOAS
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TREASURY FOR SARA SENICH
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3134/ITA/USFCS/OIO/WH/MKESHISHIAN/BARTHUR

E.O. 12958: DECL: 06/24/2018
TAGS: EFIN ECON PGOV NU
SUBJECT: NICARAGUA: VISIT OF TREASURY DAS O'NEILL COINCIDES WITH A CENIS RESOLUTION

REF: A. MANAGUA 764
¶B. MANAGUA 706
¶C. MANAGUA 481
¶D. MANAGUA 450
¶E. MANAGUA 443

Classified By: Ambassador Paul Trivelli for reasons 1.4 b&d.

¶1. (C) Summary: On May 27-29, Treasury Deputy Assistant Secretary (DAS) Brian O'Neill visited Nicaragua to participate in the Competitiveness Forum (Ref A) and privately address the CENIs case. In his meetings with the Nicaraguan Vice President, Central Bank President (BCN), Banking Superintendent, and private bankers, DAS O'Neill encouraged all parties to come to a resolution on the CENIs case as soon as possible. BCN President Rosales revealed that he had the approval of President Ortega to negotiate new deals on the CENIs and was close to a resolution with BanPro. (Note: On June 9, Rosales announced the deal, see paragraphs 9-10. End Note.) Bankers laid out the consequences for Nicaragua's economy and financial system should the CENIs case drag out too long, but suggested that President Ortega is not interested in resolving the issue. DAS O'Neill's visit relayed USG concern regarding the CENIs situation to key Nicaraguan interlocutors. While the BanPro deal has relieved some of the pressure on the CENIs case, it has not dissipated the dangers of a country risk downgrade or a portfolio revaluation for Bancentro. End Summary.

The Visit

¶2. (SBU) Treasury Deputy Assistant Secretary (DAS) for the Western Hemisphere Brian O'Neill visited Nicaragua May 27-29 to participate in the Embassy-sponsored Competitiveness Forum (Ref A) and conduct meetings regarding the CENIs case and the health of Nicaragua's financial system (Refs C-E). On May 28, DAS O'Neill met with Vice President Jaime Morales, Minister of Trade Orlando Solorzano, Central Bank President (BCN) Antenor Rosales, President of the Free Trade Zone Commission Alvaro Baltodano (Gen. Ret.), Legal Director of the Banking Superintendency Uriel Cerna, private bank representatives, and Nicaraguan business leaders. (Note: The Meeting with the Vice President is detailed in Ref A. End Note.)

CENIs) A Partial Resolution

¶3. (C) The principal focus of DAS O'Neill's agenda was to receive an update on the status of the CENIs case and to encourage all parties involved to come to a resolution as soon as possible (Refs C-E). Central Bank (BCN) President Antenor Rosales, Banking Superintendent Legal Director Uriel Cerna, and private bank representatives all concurred on a long list of serious effects on Nicaragua's financial sector should the case drag on. While BCN President Rosales announced the official agreement on a renegotiation with BanPro on June 9, the lack of a formal resolution for Bancentro means that the potential dangers surrounding the BCN's failure to pay out on the CENIs have not abated.

The Banks' Perspective

¶4. (C) During the meeting with Bancentro President Roberto Zamora, Bancentro Executive Director Julio Cardenas, BanPro General Manager Luis Rivas, and Banco Uno (Citibank) General Manager Mercedes Deshon (also president of the Association of Private Banks- ASOBANP), DAS O'Neill discussed the health of Nicaragua's banking sector in light of the GON's default on the CENIs. All agreed that the financial sector's numbers continue to look strong despite the current economic slowdown and worsening of the investment climate. However, local banks have begun to tighten credit to build liquidity to facilitate a quick response to any downgrade in bank and/or sovereign ratings by Moody's and Fitch, which could occur by June 30 if the government fails to pay. Both rating agencies have Nicaragua on a ratings watch; a downgrade would increase country risk raise the cost of credit. The banks fear that should the agencies act, large depositors might transfer funds to overseas accounts and start a run on the banks. Not withstanding, Roberto Zamora reported he was not in a hurry to finalize negotiations for Bancentro.

¶5. (C) The consequences of the CENIs case will fall first and most heavily on the private sector and the financial system. Nicaraguan banks are facing pressure from Panama's Banking Superintendent, who oversees operations of all banks incorporated in his country (including all Nicaraguan banks), to revalue their portfolios and adjust capitalization levels. The bankers do not believe President Ortega and his closest advisors understand, or care, about sovereign risk ratings and the health of the financial system.

¶6. (C) The most immediate repercussions to the GON for not paying the CENIs has been donor reluctance to disburse direct budget support funds (USD 110 million). The World Bank and IMF are holding USD 36 million in funds in abeyance until this and other conditionalities are resolved. DAS O'Neill pointed out that these amounts do not represent much leverage when compared to the USD 520 million President Ortega claims Venezuela provided in 2007. (Note: This number is not corroborated by other reports, which place the figure closer to USD 130 million. End Note.) Nonetheless, "It is still money the GON needs and cares about," Zamora noted. In addition, the BCN and Ministry of Finance have been unable to place any financial instruments with any private institution since the April 15 default, losing a key monetary policy instrument.

The Central Bank is Committed

¶7. (C) BCN President Rosales was extraordinarily candid and forthcoming during the meeting. He stated that his re-anointment by Ortega as lead CENIs negotiator is a sign that the GON takes the situation seriously. Rosales assured DAS O'Neill that President Ortega promised to accept any renegotiation terms Rosales could get as the condition for resuming leadership of the negotiations (Ref D). Rosales also announced that the agreement with BanPro was almost finalized, while talks with Bancentro were in early stages.

The BanPro agreement was publicly announced on June 9. (Note: Information recently provided to us from Bancentro indicated that those negotiations have advanced. End Note.)

¶8. (C) Rosales assured DAS O'Neill that his legal counsel is confident the BCN constitution allows him to sign the agreement "to protect the economy," without a corresponding approval from his Board. At the beginning of May, the three private sector members of the BCN Board of Directors resigned fearing prosecution if they approved a CENIs refinancing. (Note: The Comptroller General (CGR) is currently preparing cases against former BCN Board members who approved the 2003 CENIs renegotiation. End Note.) Rosales emphasized his determination to sign, even though he does not enjoy immunity from future prosecution. "Naming a new board will take too long and the dangers are worse if I don't," he explained. Bancentro and BanPro both fear Rosales' actions will be used by the Sandinistas to later backtrack on the agreement and force the banks into still another negotiation. Rosales could not provide DAS O'Neill any assurances on this point.

BanPro's CENIs Deal

¶9. (SBU) The CENIs deal with BanPro involves the exchange of the current bonos bancarios (10-year coupon bonds with an interest rate of 8.29%) for 20 year bonds at 5% for the first 15 years, then 5.25% for the last five. BanPro will receive two payments per year on each bond. As a result, in 2008 Nicaragua will pay the bank USD 4.88 million, a reduction of USD 36.25 million in the budgeted payment. While the result is a reduction of USD 30-40 million in terms of net present value, nominally the GON will pay USD 90 million more to the banks over the life of the bond issuance. These terms are far longer than any current government debt instruments and significantly below market rates (currently 10-12% for dollar denominated debt payable in cordobas at the official exchange rate at on the day of redemption.)

¶10. (C) This final deal contains only minor differences from the one Rosales presented to DAS O'Neill on May 28 -- an exchange of the current bonds for 15-year zero coupon bonds at 5%. The bonds would have varying maturity dates, starting with October 2008. Payments would start small and build over time (i.e. the larger payment burden would fall to future governments.) Rosales also stated that, at the insistence of the Panamanian Superintendent of Banks, the new bonds would be tradable, with BanPro agreeing to being selling the bonds upon receipt, starting with the longest maturities. DAS O'Neill conveyed at the May 28 meeting that he was in favor of the bonds being traded and the holders of the bonds selling them in order to create a market. (Note: It is unclear at this time whether the coupon bonds linked to the June 9 agreement will be tradable. End Note.)

¶11. (C) Meanwhile the political accusations surrounding the last CENIs restructuring continues. The Comptroller General (CGR) has indicated that he will file formal charges against opposition leader Eduardo Montealegre and other BCN board members by July. Per Ref B, the CGR is probably waiting for the most opportune time to influence the November 2008 municipal elections (in which Montealegre is running for mayor of Managua) to file criminal charges.

Banking Superintendent

¶12. (C) The Legal Director of the Banking Superintendency Uriel Cerna and Banking Intendent Soledad Balladares informed DAS O'Neill that Nicaragua is about to complete an agreement with other central American superintendencies for a consolidated supervision format, information sharing, and joint inspections. As part of this modernization process, the Superintendent is shifting to supervision based on risk analysis and is modernizing its asset assessment capabilities so it can better supervise the new micro-finance institutions coming under Superintendence authority. Cerna also detailed Nicaragua's advances in fighting money laundering, including

revision of the penal code, issuance of new banking norms that meet Egmont and Basil standards, and increased police investigations of financial crimes.

Talking Infrastructure

¶13. (SBU) In separate meetings with the Minister of Trade Orlando Solorzano and President of the Free Trade Zone Commission Alvaro Baltodano, DAS O'Neill's presentation of a new infrastructure development initiative for Latin America was well received. The initiative, funded by the U.S., Brazil, the Inter-American Development Bank (IDB), and the International Finance Corporation (IFC), helps identify projects and pays for feasibility studies. Both Solorzano and Baltodano stated that Nicaragua has a desperate need for infrastructure and lots of ideas, but needs assistance in transforming the ideas into proposals that could attract serious investors. DAS O'Neill also presented the initiative, along with the Treasury SME financing initiative, to all of the participants at the Nicaraguan Competitiveness Forum.

Comment

¶14. (C) DAS O'Neill's visit was important in relaying USG concern regarding the CENIs situation to a broad range of public and private Nicaraguan contacts. It also allowed his interlocutors to clearly lay out the consequences of non-payment. The resolution of the largest part of the CENIs has caused many to feel that the pressure is off, and consequently negotiations with Bancentro have slowed. Nevertheless, the danger of a risk downgrade and portfolio revaluation by the Panamanian Superintendent have not abated.

¶15. (U) DAS O'Neill cleared on this cable.
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